

2003

Sony Electronics, Inc. v. Visual Technology Inc. : Reply Brief

Utah Court of Appeals

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IN THE UTAH COURT OF APPEALS

SONY ELECTRONICS INC., a
Delaware corporation,

Plaintiff,

vs.

VISUAL TECHNOLOGY, INC., a
Utah corporation, ERLAND REBER, an
individual, and SHARLENE REBER, an
individual,

Defendants.

Case No. 20030883-CA
District Ct. No. 020903207

REPLY BRIEF OF APPELLANT SONY ELECTRONICS INC.

Appeal from the Judgment of the Third Judicial District Court, Salt Lake County,
Judge Leslie Lewis

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Appellant Sony Electronics Inc. (“**Sony**”) respectfully submits this reply brief in response to the brief of the Appellees, Erland and Sharlene Reber (the “**Rebers**”).

SUMMARY OF THE ARGUMENT

The issue in this appeal is whether the trial court properly dismissed Sony’s breach of contract claim against the Rebers under Rule 12(b)(6) of the Utah Rules of Civil Procedure. As explained in Appellant’s opening brief, Sony brought suit against the Rebers under a written Guaranty Agreement (the “**Guaranty**”), pursuant to which the Rebers agreed to guarantee payment of the debts of Visual Technology, Inc. (“**Visual Technology**”). The Rebers claim that they cannot be held liable under the Guaranty because they previously sold the assets of Visual Technology to a new entity that subsequently changed its name to “Visual Technology, Inc.,” the exact same name of the entity identified in the Guaranty¹, and because the debt in question was incurred by the new entity. The Rebers, however, never revoked their Guaranty or informed Sony of the asset sale. In essence, the Rebers claim that they cannot be held liable under the Guaranty because Visual Technology, as operated by its new owner, Bruce Jackson, is a different corporate entity than the Visual Technology operated by the Rebers. Although these defenses involve factual questions, the trial court dismissed Sony’s complaint as a matter of law under Rule 12(b)(6), without affording Sony as opportunity to investigate the Rebers’ factual arguments through discovery, and without allowing Sony to amend its complaint if new claims came to light as a result of that discovery.

¹ The Rebers obviously were complicit in this deception because the new entity could not have changed its name without the consent of the former entity which was controlled by the Rebers. See. U.C.A. §§ 16-10a-401(2)(a) and -401(3)(a) & (b)(i)(A).

The dismissal was in error for two separate reasons. First, the trial court erred by making findings of fact that contradicted the pleadings in order to reach the conclusion that Visual Technology was a different corporate debtor from the entity owned by the Rebers. In deciding a motion to dismiss under Rule 12(b)(6), the trial court is required to assume that the facts plead in Sony's complaint are true, and it must consider those facts in the light most favorable to Sony. Instead of granting Sony the deference mandated by Rule 12(b)(6), the trial court entered a factual conclusion that contradicted the pleadings. At a minimum, Sony should have been allowed to conduct discovery in order to rebut the Rebers' factual contentions.

Second, even if the Rebers' untested assertions regarding the asset sale were true, the Rebers' remained liable for Visual Technology's debt because they failed to revoke their written Guaranty. Controlling Utah law provides that a guaranty remains in effect until it is revoked in writing by the guarantor. In addition, both the language of the Guaranty and Utah law recognize that a guaranty remains enforceable despite any subsequent changes in the debtor's name, location, or corporate structure. Accordingly, the trial court's ruling that the Rebers could not be held liable was error as a matter of law.

ARGUMENT

I. The Trial Court Erred by Entering Findings of Fact that Contradict the Well-Plead Allegations of the Complaint.

The trial court erred in dismissing Sony's complaint against the Rebers because the complaint adequately pleads a claim for breach of contract. In deciding a motion to

dismiss under Rule 12(b)(6), the trial court is required to “assume that the factual allegations in the complaint are true, and [to] draw all reasonable inferences in the light most favorable to the plaintiff.” Cazares v. Cosby, 2003 UT 3, ¶ 13, 65 P.3d 1184, 1187 (Utah 2003) (quoting Valley Colour, Inc. v. Beuchert Builders, Inc., 944 P.2d 361, 362 (Utah 1997)). Thus, when deciding a motion to dismiss under Rule 12(b)(6), the trial court is merely reviewing “the formal sufficiency of the claim for relief.” Id. at ¶ 15.

In this case, the Rebers cannot reasonably dispute that Sony’s complaint was “formally sufficient.” To state a cause of action for breach of contract under Utah law, Sony must allege four elements: (i) the existence of a contract; (ii) performance by the plaintiff; (iii) non-performance by the defendant; and (iv) damages. Mackey v. Cannon, 2000 UT App 36, ¶ 13, 996 P.2d 1081, 1084. Sony’s complaint meets these elements. The complaint alleges that the Guaranty is a valid and binding contract, that Sony shipped goods for which it was not paid, and that it was damaged as a result of the Rebers’ failure to honor the Guaranty. (R. 4-5) Although the Rebers’ may ultimately assert their “new entity” defenses at trial or during later stages of the proceeding, it was not proper to dismiss the Complaint under Rule 12(6)(b) because it sufficiently plead a cause of action.

Rather than accepting the allegations of the complaint as true, the trial court drew its own factual conclusions from the pleadings and submissions *outside the Complaint*. Specifically, the trial court concluded that Visual Technology, as operated by Bruce Jackson, was an entirely different corporate entity than the Visual Technology owned by

the Rebers.² (R. 290). The trial court based this finding on the fact that Visual Technology had changed its address from the location listed in the Guaranty, and that the company had changed its corporate signatory over time. (Id.) The trial court erred in making these findings for at least three reasons.

First, the trial court is not permitted to enter findings contrary to the allegations of the complaint in ruling on a 12(b)(6) motion. As noted above, Rule 12(b)(6) requires the trial court to assume that the facts alleged are true, and to construe any inferences in favor of the plaintiff. Here, the trial court construed the facts against Sony. As discussed at length in Sony's opening brief, there are a number of legitimate reasons why a corporation may change its address (i.e., moving to a better location or negotiating a better lease), or for that matter, use more than one address on correspondence (i.e., multiple locations, etc.). The use of secondary address would affect its ownership or structure. By the same token, corporations routinely change signatories or authorize more than one signatory to conduct their affairs. In fact, companies routinely authorize even lower level employees to sign for the shipment of inventory. None of the facts that the trial court relied on – when construed in the light most favorable to the plaintiff – suggest that the company has become an entirely different corporate entity as a matter of law. Taken to its logical conclusion, the trial court's ruling suggests that any time a debtor changes its address or authorizes another person to sign for inventory, all of its

² Given an opportunity to conduct discovery, Sony may have been able to establish that the so-called "new entity" was, in fact, an alter ego of the former entity, or that, for other reasons, the Rebers should be held liable for the debts of the new entity because of their personal involvement in, or personal gain from, the deceptive use of the same name without providing any notice of the change to the creditors of the former entity.

credit agreements and other contracts become void as a matter of law. This is not, and cannot be, the law for obvious reasons.

Second, the Guaranty specifically provides that the Rebers would remain obligated to pay Visual Technology's debts, *even if* the company subsequently changed its address or personnel. Section 3 of the Guaranty states:

Character of the Obligation. This Guaranty is an absolute, continuing, unconditional and unlimited Guaranty. ... This Guaranty shall be effective regardless of any subsequent incorporation, reorganization, merger or consolidation of the Debtor, change in partners, change of name or any other change in the composition, nature, personnel or *location* of the Debtor whatsoever.

(R. 13-14). Thus, in negotiating their agreement, the parties specifically anticipated that Visual Technology may one day wish to change its management or location, and specifically provided that the Rebers would remain liable under the Guaranty notwithstanding any such changes.³

Third, if the trial court considered Visual Technology's change in address and signatory dispositive, it should have allowed Sony to conduct discovery in order to explore the circumstances surrounding these events. Discovery may have demonstrated that the Rebers intentionally concealed their sale of Visual Technology's assets from its creditors, or that they continued to participate in the company's affairs following the sale to Mr. Jackson. These facts could have allowed Sony to pursue its claims under an alter

³ On pages 23-24 of their brief, the Rebers argue that the address of Visual Technology was an "identifying characteristic" of the debtor, such that the Guaranty should only be construed to apply to goods sold to Visual Technology at 2155 S. Main. Paragraph 3 of the Guaranty expressly contradicts this argument, and demonstrates that the parties knew and understood that Visual Technology may one day change its location.

ego or successor liability theory.⁴ However, because the trial court refused to allow discovery, Sony had no opportunity to rebut the Rebers' allegations. Under these circumstances, dismissal was inappropriate. See Utah R. Civ. P. 12(b) (providing that parties are to be given a "reasonable opportunity" to present rebuttal materials).

In response to these arguments, the Rebers contend that the trial court properly entered findings of fact under Rule 52(a) of the Utah Rules of Civil Procedure in dismissing Sony's complaint. See Rebers' Br. at 19. This argument misses the point. As a threshold matter, Rule 52(a) applies to matters "tried upon the fact without a jury or with an advisory jury" and to matters in which the trial court is required to "judge the credibility of the witnesses." See Utah R. Civ. P. 52(a). Because this issue never advanced to discovery or trial, there was no opportunity for the trial court to hear and evaluate the factual evidence. In essence, the Rebers asked the trial court to try the merits of the entire case and enter fact findings, without ever hearing witnesses or reviewing all relevant documentary evidence. This is not an appropriate basis for invoking Rule 52(a).

In any event, Rebers' argument is irrelevant. The Rebers admit that even if Rule 52(a) were construed to allow the trial court to enter findings of fact, the findings must be "in line with the allegations of the complaint." Rebers' Br. at 19-20. Here, however, the trial court erroneously substituted its own findings regarding the corporate structure of Visual Technology for those plead in the complaint. Because the trial court failed to

⁴ The Guaranty provide that it "shall be binding upon and inure to the benefit of the successors and assigns of the parties." (R. 15, ¶ 10).

accept Sony's allegations as true, or at a minimum, allow discovery on the Rebers' factual claims, its decision was erroneous.

II. The Rebers Remain Liable on the Guaranty Because they Failed to Revoke Their Obligations in Writing.

The trial court's dismissal should also be reversed because the trial court misinterpreted Utah law regarding the enforceability of the Guaranty. Under Utah law, a guaranty remains effective until it is revoked in writing by the guarantor.⁵ See, e.g., Strevell-Paterson Co., Inc. v. Francis, 646 P.2d 741, 742 (Utah 1982); Cessna Finance Corp. v. Meyer, 575 P.2d 1048, 1050 (Utah 1978); Mule-Hide Products Co. v. White, 2002 UT App 1, ¶ 15 40 P.3d 1155, 1159. Moreover, unless properly revoked, a guaranty will continue to be effective despite any subsequent changes in the corporate debtor's ownership, structure, or management. See, e.g. Zions First National Bank v. Hurst, 570 P.2d 1031 (Utah 1977), Mule-Hide Products, Inc. v. White, 40 P.3d 1155 (Utah Ct. App. 2002).⁶

⁵ Though not directly raised in this appeal, at the trial court level, there was an issue as to whether New Jersey law should have governed the Guaranty. To the extent New Jersey law applies, it follows the general position accepted by the Utah courts that a guaranty remains effective until revoked in writing. See e.g., Summit Trust Company v. Willow Business Park, 269 N.J. Super. 439,444-45 (N.J. Super. Ct. 1994)(guarantor liable for failing to obtain a release from the creditor); First New Jersey Bank v. F.L.M. Business Machines, Inc., 325 A.2d 843, 849-50 (N.J. Super. 1974) (guarantor liable for future advances made prior to revocation); Swift & Co. v. Smigel, 279 A.2d 895, 899 (N.J. Super. Ct. 1971)(enforcing guaranty against incompetent where guarantor's estate failed to revoke agreement).

⁶ Case law from other jurisdictions also supports this principle. See, e.g., Loving & Associates v. Carothers, 619 N.W.2d 782 (Minn. Ct. App. 2000) (merger did not release guarantor from contractual obligation); Sun Bank / Treasure Coast v. Goldman, 580 So.2d 291 (Fla. Ct. App. 1991) (guarantors liable on corporate debt following merger and

In this case, it is undisputed that the Rebers never revoked their Guaranty, and never provided Sony with notice that they no longer intended to be held liable for the debts of Visual Technology. Instead, the Rebers (perhaps even intentionally)⁷ allowed Sony to continue selling goods on credit in reliance on the Guaranty. The Rebers' Sale Agreement with Mr. Jackson indicates that the Rebers sold their business as a going concern, and that they had an affirmative obligation to operate the business in its customary fashion prior to Mr. Jackson's taking possession. Among other things, the Rebers were required to maintain regular business hours, pricing, and inventory, and to refrain from conducting "liquidation" or "close-out sales." (R. 68). These provisions were undoubtedly intended to protect Visual Technology's goodwill by providing continuity to its customers. Without affirmative notice, creditors like Sony had no reason to suspect that the company was changing ownership.

More importantly, public policy requires that the Rebers remain liable on the Guaranty. The Rebers were the *only* party with knowledge of the asset sale – they had the ability to avoid liability by simply informing Sony of the sale and their intent to revoke. However, they chose to do nothing. Had Sony been informed of the change in

subsequent asset transfer); Farmer v. Peoples American Bank, 209 S.E.2d 80 (Ga. Ct. App. 1974) (stockholder liable on guaranty following change in corporate ownership).

⁷ As indicated in Sony's opening memorandum, the Rebers had an incentive to conceal the change in ownership from Visual Technology's creditors, as they were paid for the asset sale over time by promissory note. By preserving Visual Technology's ongoing business relationships with its creditors, the Rebers could increase the likelihood of the business succeeding, and in turn, the likelihood of their note being paid. Because Sony was denied its request for discovery, it was not permitted to fully explore the circumstances surrounding the Rebers' failure to revoke.

ownership, it could have requested a new guaranty from Visual Technology's new officers, or even terminated the credit relationship altogether. By remaining silent, the Rebers deprived Sony of the opportunity to protect itself in the event of default. Because the Rebers chose to conceal these facts from Sony, they remained liable on the Guaranty. See, e.g., Mountain States Telephone & Telegraph, 504 P.2d 807, 809 (Idaho 1972).⁸

In their opposition, the Rebers make three arguments in an attempt to extinguish their liability under the Guaranty. First, they argue that the Mule-Hide Products v. White, which Sony relies on, is distinguishable. (Rebers' Br. at 30). Second, the Rebers argue that the Guaranty must be narrowly construed against Sony under Lester Piano Company v. Romney, 126 P.325, 41 Utah 436 (Utah 1912). (Id. at 22-28). Finally, the Rebers argue that Sony failed to give adequate notice of "the revocation issue" in its complaint. (Rebers' Br. at 29). Each of these arguments lacks merit.

A. Mule-Hide Products is Controlling and Establishes that the Guaranty is Enforceable.

In their opposition, the Rebers ignore the wide body of case law recognizing that a guaranty remains in effect unless it is revoked in writing. Instead, the Rebers focus their efforts on distinguishing their conduct from Mule-Hide Products v. White, a case which

⁸ In addition, it is important to note that just because the Rebers are held liable to Sony under the Guaranty, it does not necessarily follow that they will be out the value of debt without any recourse. The Rebers would have a cross-claim against Visual Technology (or a third-party complaint against Mr. Jackson) for breach of their Sales Agreement obligations. This is simply a matter of allocating the burden of collecting this unpaid obligations among sophisticated parties.

is on all-fours with this action.⁹ As discussed at length in Sony’s opening brief, Mule-Hide Products involved a situation where the guarantor, White, sold the assets of the corporate debtor to another business. See 40 P.3d at 1157. White failed to inform her creditors of the sale, and failed to revoke her guaranty. Id. The trial court concluded, and this Court agreed, that White remained liable on her guaranty even though she had sold the assets of the company. Id. at 1159.

The Rebers contend that the present case is distinguishable from Mule-Hide Products because “Sony’s products were ordered from, delivered and accepted at a different address from that defined in the Guaranty.” Rebers’ Br. at 31. The Rebers’ argument is irrelevant. As noted above, Section 3 of the Guaranty distinctly provides that the Guaranty would remain enforceable *even if* Visual Technology subsequently changed its location. Thus, there is no basis for contending that the shipment of goods to a different address would relieve the Rebers’ from their contractual obligations.

Moreover, this Court’s holding in Mule-Hide Products does not simply “boil[] down to who had really purchased the goods...” as the Rebers contend. See Rebers’ Br. at 30. Rather, this Court’s focus in Mule-Hide Products was on the guarantor’s failure to revoke her guaranty:

Further, regardless of any knowledge or presumed knowledge by either White [the guarantor] or Mule-Hide [the creditor], a guarantor is held liable for the guaranteed debts which were incurred notwithstanding any substantial change in the financial structure and organization. In *Mountain States Tel. & Tel.*, the court stressed that the guarantor, to have escaped liability, should have properly withdrawn from his guaranty obligation.

⁹ The facts of Mule-Hide Products are discussed at length in Sony’s opening brief at page 17.

Thus, even if the trial court erred in finding White knew her husband used her purchase order to order materials from Mule-Hide, the error was harmless because her knowledge is not determinative where she did nothing to revoke the agreement or guaranty.

Mule-Hide Products, 2002 UT App. 1 ¶¶ 16-17. Consistent with the principles outlined in Mule-Hide Products, this Court should conclude that the Rebers remained liable on their Guaranty because it was never revoked in writing.

B. Lester Piano is Distinguishable on Multiple Grounds.

Unable to refute this Court's holding in Mule-Hide, the Rebers contend that this Court should construe the Rebers' Guaranty narrowly under a dated Utah case, Lester Piano Company v. Romney, 126 P.2 325, 41 Utah 436 (Utah 1912). Lester Piano, however, is distinguishable on multiple grounds. To begin with, in Lester Piano, the Court held that there was no enforceable guaranty between the parties because the creditor had rejected the defendant's proposed form of guaranty. Id. at 328. Therefore, unlike the present case, there was no contractual guaranty in effect at the time of the debtor's default.

Further, Lester Piano is also distinguishable in that the Court found that the creditor had been given notice of the change in ownership. Id. at 326. Specifically, the Court noted that an officer of the company had notified the plaintiff creditor of the changes in company's stock ownership and articles of incorporation. Id. at 326-327. In this case, the Rebers never took any measures to notify Sony of the asset sale.

Finally, unlike the present case, the debtor in Lester Piano changed its legal name from Daynes & Romney Piano Company to Daynes-Romney Music Company following

the change in corporate ownership. Id. at 327. Here, however, Sony was dealing with an entity with *the exact same legal name as the corporation with which it had originally contracted*. Under these circumstances, there was no reason for Sony to suspect that the Rebers had sold the assets of Visual Technology, and no reason for Sony to question the ongoing validity of the Guaranty.

C. Sony Was Not Required to Give Notice of the Rebers' Failure to Revoke Their Guaranty in the Complaint.

As a final argument, the Rebers contend that they cannot be held liable under their Guaranty because Sony failed to give adequate notice of the “revocation issue” in the complaint. See Rebers’ Br. at 29. In particular, the Rebers’ claim that Sony’s complaint is somehow flawed because the “first time the issue or any factual allegations pertaining to revocation arose was in Sony’s opposing memorandum to the Rebers’ Motion to Dismiss.” Id. The Rebers’ argument is logically flawed.

As noted numerous times above, Sony was never given notice of the Rebers’ asset sale and was never notified of the Rebers’ intent to revoke their Guaranty. To the contrary, Sony *relied* on the continued validity of the Guaranty in selling goods to Visual Technology on credit. Under these circumstances, Sony could not have plead the Rebers’ failure to revoke as part of its complaint, as did not learn of the Rebers’ refusal to honor the Guaranty until after litigation ensued.

Moreover, there is no requirement that Sony plead the Rebers’ failure to revoke as part of its complaint for breach of contract. To the extent revocation is at issue, it is an affirmative defense that must be raised by the Rebers. See Utah R. Civ. P. 8(c) (listing

release among affirmative defenses to be plead by defendant). The Rebers alone carry the burden of raising the issue and proving the validity of their defense at trial.

III. The Rebers Request for Fees on Appeal Should Be Denied.

The Rebers' request for their fees in defending this appeal should also be denied. Although Sony does not dispute that Utah Code Ann. § 78-27-56.5 recognizes a reciprocal right to recover fees under a contract clause, that provision is limited to cases where the party is seeking to enforce the agreement. In contrast, when a party (such as the Rebers) seeks to avoid their obligations under the contract, Utah courts have refused to recognize such a reciprocal right. See e.g. BLT Inv. Co. v. Snow, 586 P.2d 456, 458 (Utah 1978); Anglin v. Contracting Fabrication Machining, Inc., 2001 UT App. 341, ¶¶ 10-12. The basis for this rule is clear – if the Rebers are not subject to the obligations of the contract, they cannot be afforded the benefits of the contract, including the rights afforded by an attorney's fees clause. BLT Inv. Co. v. Snow, 586 P.2d 456, 458 (Utah 1978) (a defendant “may not avoid the contract and, at the same time, claim the benefit of this provision for attorney fees”).

Furthermore, even if this Court were to find that fees were recoverable, it does not mean that an award must be granted. Section 78-27-56.5 is “discretionary” – not mandatory. The statute provides that the Court “may” award costs and attorney's fees, not that it “shall” award such costs and fees. In this case, equitable principles mandate that the Rebers' request for attorney's fees be denied.

Among other obligations, the Guaranty provided that the Rebers would serve any notices to Sony by certified or registered mail. See (R. 15 at ¶ 15). The Guaranty also

provides that the Rebers' obligations survive *any subsequent change* in "incorporation, reorganization, ... or any other change in the composition, nature, personnel, or location of the Debtor" and is binding upon the parties' successors or assigns. See (R. 14-15, at ¶¶ 3, 10.) Like any other corporation which extends credit to a local business, Sony relied on the notice and survival provisions of the Guaranty when it entered into the agreement, and Sony expected that the Rebers would abide by these provisions during their business relationship. See id. at ¶ 2.

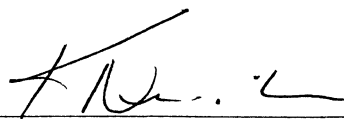
When or if the Rebers ceased operating their business they did not revoke the Guaranty, and they failed to serve Sony with certified notice of the substantial change in their operations. Although abiding by these obligations would have prevented this lawsuit, the Rebers chose to ignore these obligations under the Guaranty. Instead, they sold the corporation and its assets without informing their creditors, including Sony, of this change, and without providing Sony, and their other creditors, with an opportunity to either discontinue providing credit to the new entity without a reaffirmation of the Guaranty or establish new financial arrangements with the new owners. For the Court to excuse the Rebers from compliance with their contractual obligations under the Guaranty, while, at the same time, allowing them to assert rights against Sony under the same document, would be contrary to § 78-27-56 and public policy. Therefore, under the circumstances of this case, and even if the Court concludes that the statute is applicable, the Court should exercise its discretion to deny any award to the Rebers because of their failure to comply with the notice provisions of the same document.

CONCLUSION

The trial court erred in dismissing Sony's Complaint under Rule 12(b)(6). The trial court failed to accept Sony's well-plead allegations as true, and, instead, improperly relied upon its own unsupported findings of fact. To the extent these facts, if true, would have been outcome determinative, the trial court erred in denying Sony the opportunity to conduct discovery on the factual claims. Further, even if the Rebers' assertions of fact are true, the trial court misapplied Utah law. Under Mule-Hide Products and related cases, the Rebers' Guaranty remained in effect until revoked in writing, notwithstanding any changes in the debtor's name, location, or corporate structure.

Sony requests that the judgment of the trial court be reversed, and that the case be remanded to the lower court with instructions to enter a judgment finding that the Rebers' Guaranty is enforceable as a matter of law. In addition, Rebers should be required to answer the Complaint. Thereafter, Sony should be permitted to conduct discovery regarding the circumstances surrounding any defenses that are asserted by the Rebers', and, if appropriate, seek amendment of its complaint to assert additional causes of action.

DATED this 30th day of July, 2004.



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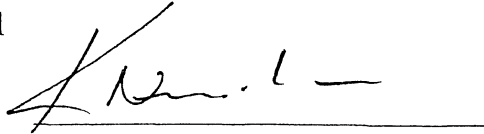
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CERTIFICATE OF SERVICE

I hereby certify that I caused to be mailed, first class postage prepaid, two copies
of the foregoing on the 30th day of July, 2004, to:

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350 South 400 East, Suite 101A
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A handwritten signature in black ink, appearing to read "Elizabeth M. Peck", is written over a horizontal line.